Application by BellSouth Corporation,	)	
BellSouth Telecommunications, Inc., and	)	
BellSouth Long Distance, Inc. for Provision	)	**Docket No. 98-121**
of In-Region, Interlata Services for Louisiana	)	

Comments of Robert E. Litan and Roger G. Noll[1]

July 28, 1998

Executive Summary

We are filing this statement to encourage the Federal Communications Commission (FCC) to set forth clear guidelines for how BellSouth and other Bell Operating Companies (BOCs) can satisfy the "public interest" test of Section 271(c)(1) of the Telecommunications Act of 1966, presuming they otherwise have met the full competitive checklist also required by the Act for entry into InterLATA long-distance telecommunications services within their regions.[2] We urge the Commission to use the line of analysis presented below in deciding whether to grant this particular application and similar ones that may be filed by other BOCs in the future.

In brief, we recommend that the Commission establish a presumption that BOC entry into long-distance is in the public interest where at least half of the consumers of local telecommunications services in the region have the ability to choose among two other predominantly facilities-based local carriers (other than the local BOC) offering service at a cost and quality that is roughly equivalent to the wireline access service available from the incumbent BOC. Where a BOC cannot satisfy this test on a statewide basis, we recommend that the

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[1]Biographical information about the authors is provided in the Appendix. The views expressed in this statement are those of the authors and not those of the institutions with which they are affiliated.

[2]Throughout this filing where we refer to "long-distance" services we mean in-region InterLATA long-distance.

Commission encourage it to apply for and meet the test on a less-than-statewide basis or for particular customer classes within the state. Such "less than statewide" entry can be consistent with, and indeed well serve, the public interest in areas where facilities-based carriers are already providing local service, and thus could help speed the arrival of true competition to the long-distance market in a fashion that minimizes the well-established risks of premature BOC entry.

Introduction

The Telecommunications Act of 1996 created the expectation that the telecommunications industry could be made substantially more competitive. The Act even held out the hope – indeed, the expectation – that competition would soon come to the last bastion of monopoly in the telephone industry, basic local access. In particular, the Act envisioned ending the monopolies of the Bell Operating Companies in local telephone service, while enhancing competition in interexchange (or long-distance) telecommunications. Neither result has come to pass.

Now, more than two years later, frustration has mounted among consumers, policy makers, and many telecommunications firms over the slow progress that has been made toward achieving more competition, especially in local service. The finger pointing to identify the villains has begun. In the spring of 1998, for example. Californians have been treated to a television ad campaign in which Southwest Bell and long distance carriers blame each other for the slow progress. We offer these comments in the hope that analysis is more effective than public relations in identifying how to implement the vision embodied in the Act.

Caught in the middle of the current controversy is the FCC, which bears responsibility

under the Act for determining whether a BOC that seeks permission to enter the interLATA long-distance market within its region (hereinafter simply "long-distance") has met the Act's legal criteria: compliance with the fourteen requirements in the "checklist" in Section 271(c)(1) of the Act and proof that entry would be "consistent with the public interest, convenience and necessity."[3] To date, no BOC application has established compliance with the full checklist, so the FCC has not yet had to decide on public interest grounds whether approval is warranted. Nonetheless, in its August 19, 1997, decision denying Ameritech's application [hereinafter the "FCC's Second Ameritech Decision"] the Commission outlined in some detail the factors it will take into account in deciding whether future applications are in the "public interest."[4]

The purpose of this statement is to encourage the Commission to establish clear guidelines about how a BOC could satisfy the public interest test. We believe additional guidance would be useful in providing a more definite road map to the BOCs and their opponents alike of the circumstances under which BOC applications under Section 271 will be granted. Greater clarity will enable BOCs to anticipate more accurately the conditions that must prevail before an application for entry into long distance service will be approved. As a result,

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[3]The Act sets out two "tracks" for BOC entry. Track A (outlined in subsection (c)(1)(A)) applies if the BOC has entered into at least one binding agreement to provide access and interconnection to one more unaffiliated firm providing residential and business telephone service predominantly or wholly through its own facilities. Track B (outlined in subsection (c)(1)(B)) pertains to situations in which no unaffiliated competitor had requested such access after 10 months of the date of enactment (December. 1996). The analysis contained in this statement applies to both tracks.

[4]FCC Memorandum Opinion And Order, CC Docket No. 97-137 (August 19, 1997). We refer to this order as the "Second Ameritech Decision" because it was the second time that the FCC considered, but ultimately denied, a petition by Ameritech to enter the long-distance market.

clarity will reduce the number of unsuccessful 271 applications, thereby eliminating wasteful expenditures by private parties as well as economizing on the scarce time and resources of the Commission. Greater clarity also will create a more reliable link between BOC investments to facilitate competition and the ultimate fate of their 271 applications, thereby improving the incentive to undertake such expenditures. Consequently, greater certainty in regulatory outcomes also is likely to speed the day when BOCs can satisfy the legal criteria and thereby help bring to consumers the benefits of greater competition in both local and long-distance telecommunications services.

Toward this end, we offer a proposal that, notwithstanding the precise legal terminology that might be used to implement it, is intended to allocate the burden of proof concerning the social desirability of BOC entry into long distance. In particular, we urge the FCC to adopt an interpretation of the public interest standard that divides 271 applications into three categories: those that clearly should be denied (such as those that do not satisfy the check-list); those in which the BOC has made sufficient efforts to accommodate entry in local service and where entry is sufficiently robust so that the opponents of BOC entry into long distance bear the burden of proof that entry is not in the public interest; and an intermediate case in which the checklist has been satisfied but local competition is not particularly vigorous, so that the BOC bears the burden of proof that its entry into long distance is in the public interest.

Present Status of the Public Interest Test

The FCC's Second Ameritech Decision clarified three points about the public interest requirement under Section 271. First, satisfying the checklist alone is not sufficient to warrant

approval of a BOC's application to enter the long-distance market. For the public interest test to mean anything at all, it must require the petitioning BOC to demonstrate that its entry into long-distance, among other things, would further the purposes of the 1996 Act.[5] Second, the Commission has broad discretion in deciding what factors to take into account in deciding whether a petitioner has met this test. These factors are not limited solely to the impact of BOC entry on competition in the long-distance market, nor are they confined solely to traditional antitrust considerations. Third, among the "public interest" issues to be considered is the extent of competition in the BOC's local service market. By requiring BOCs to provide access to their networks to competitors, Congress displayed independent interest in promoting competition in local telecommunications service as well as long distance.

In the FCC's Second Ameritech Decision, the Commission also set out a series of factors it will consider in deciding whether the public interest test has been satisfied, including:

* Whether and to what extent competitors are offering local telecommunications services to different classes of customers (residential and business) through a variety of arrangements (resale, use of some unbundled services of the BOC, or entirely through the competitors' own facilities) in different geographic regions of a state (urban, suburban, and rural) and at different scales of operation (small and large);

* In the absence of "broad-based" local competition, whether and to what extent the BOC is "ready, willing and able" to provide interconnection to its network;

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[5]The Commission specifically noted (at paragraph 389) that Congress rejected an amendment that would have equated fulfillment of the checklist items with satisfying the public interest requirement. Because a statute can not imply a rejected provision, Congress must have intended the public interest requirement to be a *supplemental* precondition for allowing BOC entry into long-distance.

* Whether the BOC has agreed to a system of continuous monitoring of its performance in providing interconnection, including whether the BOC has agreed to private and self-executing enforcement mechanisms (outside of the regulatory or judicial systems) that are triggered by non-compliance with the performance standards;

* Whether the BOC has provided new entrants with optional plans for paying non-recurring charges in ways that do not require large, up-front payments;

* Whether state and local laws or other legal requirements impede entry by competitors in local telecommunications markets; and

* Whether the BOC has previously engaged in anticompetitive or discriminatory conduct.

While the Commission has performed a valuable service in identifying these factors as highly relevant to deciding whether any particular BOC application meets the public interest test set forth in the Act, the Commission has yet to assign priorities and weights among these factors, nor to indicate exactly what a BOC needs to do to satisfy the Commission with respect to each of these issues. In our view, the Commission possesses sufficient information to clarify the standards it will use to evaluate future BOC applications, and we urge it to do so.

Consumers and telecommunications providers alike are best served when regulatory rules are as clear as possible. If rules are clearly delineated, providers can make long-term investment decisions. In many parts of telecommunications, successful entry requires considerable capital investments. These investments are more likely to be forthcoming if regulatory uncertainty is minimized. From the perspective of the BOCs, more certain rules will clarify exactly what investments a BOC must make to facilitate, or at the very least not to impede, the entry of competitors before it will be allowed to enter long distance. Similarly, greater certainty about

the rules of BOC entry – especially the default rules regarding entry in the absence of facilities-based local competition – will assist local service entrants (especially the present long distance carriers) in developing their own strategic plans for local service.

With these objectives in mind we outline below a framework for making public interest determinations under the Act that builds on the important contribution the FCC has made thus far, but that refines it in a way that helps reduce the uncertainty about the conditions under which BOC entry is most likely to be found to be in the public interest.

A Framework for Deciding Whether BOC Entry Is in the Public Interest

Reduced to its essence, the "public interest" test requires the Commission to *balance*. At the broadest level, the Commission must decide whether the benefits of allowing BOC entry into long-distance outweigh the potential harms of granting such approval before local access service is reasonably competitive.

BOC entry into long-distance arguably could provide four benefits: the convenience of one-stop shopping for all telecommunications services to consumers; reductions in business costs from spreading the fixed costs of marketing and service departments across both local and long-distance services; efficiency gains arising from integrating local and long distance networks; and service improvements and price reductions due to greater competition in long distance service. If BOC entry into long distance were costless, the possibility that these benefits might arise would be sufficient to justify granting BOCs permission to enter long distance. Indeed, if BOC long distance entry brought no dangers, entry regulation of long distance would be unnecessary and even pernicious. But both historical experience and economic analysis lead

to the conclusion that BOC entry into long distance brings significant risks, as we outline below. Consequently, the proper balancing test requires addressing with precision the likely importance of these benefits.

Convenience and Efficiency

Both long distance and local service companies believe that integrated long-distance and local-access service promises significant efficiency benefits: convenience for consumers in one-stop shopping, and economies of scale and scope through marketing, billing, and integrating local and long distance networks. In reality, no hard evidence has been provided that indicates that these benefits are more than theoretical possibilities of uncertain magnitude.

Worth bearing in mind are two facts about recent history. First, defenders of the old Bell System predicted that the divestiture of AT&T would cause substantial costs because it eliminated supposedly beneficial vertical integration. In fact, divestiture ushered in an era of unprecedented technological progress – both service enhancements, such as the Internet and high-speed digital transmission, and cost reductions. Second, the one large local access provider that was allowed to remain integrated – GTE and Sprint – did not enjoy efficiency advantages from its integration, and eventually these local and long distance providers voluntarily separated. Thus, recent historical evidence does not support the view that the gains from vertical integration by themselves are likely to be very large.

Under normal circumstances, even though we concluded from the available evidence that the benefits of vertical integration were small or nonexistent, we would offer no objection to a company backing its business assessment by investing in vertical integration. But in this instance, the Commission must make an independent judgement about the merits of vertical

integration if it believes that BOC entry into long distance risks significant anticompetitive harms. For reasons given below, we believe that, in fact, the risks of BOC entry into long distance are substantial if entry occurs before local access service is reasonably competitive. If this belief is correct, then at minimum the BOCs must bear the burden of proof that the efficiency benefits of vertical integration are sufficient to offset the anticompetitive harms.

Competition in Long Distance Service

Presently about 900 companies offer some form of long distance service. Most of these companies are either independent marketers, resellers, or small, regional facilities-based carriers that offer a very specialized service, such as connecting two nearby cities. Four large carriers -- AT&T, MCI, Sprint, and Worldcom -- collectively account for nearly all actual carriage of long-distance communications, regardless of the identity of the retail entity. Consequently, long distance service is one of the more concentrated markets in the American economy, although it is not as concentrated as many markets that never have been regulated.

Despite this concentration, the performance of the long distance service business indicates that it has become substantially more competitive. The dominant carrier, AT&T, which once enjoyed a monopoly, has lost about half its market share in long-distance, with most of this loss coming since the Modification of Final Judgment required that AT&T divest its local service affiliates and that these affiliates provide all long-distance carriers with equivalent interconnection arrangements ("equal access"). In addition, actual transactions prices for long distance calls have fallen dramatically (faster than the fall in unit costs), especially for large commercial customers.

BOC entry, if it did not thwart local service competition or lead to anti-competitive re-

monopolization of long distance service, could further deconcentrate the long-distance market, perhaps bringing lower prices and/or improved service for consumers of long-distance services. Yet this result is not guaranteed. BOC entry into long distance could fail to deliver the benefits just described and generate net harm -- relative to the status quo -- to consumers in both the long-distance and local telecommunications markets.

The Risks of BOC Entry in Long Distance

The dangers of premature BOC entry into long-distance arise from the fact that BOCs enjoy considerable market power in local service yet are prevented by state regulation from fully exploiting their monopoly power in pricing local telecommunications services. Entry by a BOC into related markets where competitors require interconnection with its local network offers an opportunity for the BOC to transfer some of their monopoly power in local service to other unregulated markets, and thereby to enjoy monopoly profits from leveraging market power. By engaging in various forms of discrimination in favor of long-distance affiliates, BOCs can raise the costs and lower service quality of long-distance rivals. For example, BOCs have the ability and, as long as they maintain a regulated monopoly in network access, the incentive to engage in various forms of subtle discrimination: providing slightly inferior service to competitors, providing slow and/or ineffective repair and maintenance, and perhaps most importantly, scheduling deployment of network innovations so that competitors are the last to enjoy them. These practices would reduce effective competition in long distance while allowing a BOC's long-distance affiliate to charge super-competitive prices and enjoy monopoly profits.

While regulators theoretically have the authority to prevent anti-competitive discrimination, in practice this authority is a crude and imperfect defense. The Section 271

checklist requires BOCs to provide competitors with non-discriminatory access to local networks (including local loop transmission, transport, switching, and other services). In theory, the Act provides the FCC with sufficient authority to address these dangers by imposing penalties on the BOCs and ultimately suspending their authority to offer long-distance services if they are proved to have engaged in discriminatory practices. In practice, the FCC has limited resources with which to investigate allegations of discrimination, and in any case the penalties imposed can pale in comparison to the benefits a BOC may realize from engaging in discrimination. Before the passage of the Telecommunications Act of 1996, these problems were apparent in the difficulties that the FCC faced in implementing accounting separations of regulated and unregulated services of the BOCs in order to prevent anti-competitive cross-subsidization in the implementation of the FCC's price-cap regulation of BOC interconnections for interstate services.

The threat that long-distance authority could be revoked provides less deterrence against BOC misbehavior than may appear from a surface reading of the Act because lengthy regulatory and judicial proceedings certainly would be required before revocation could become effective. Moreover, the prospect of causing interruptions in the long-distance service of a BOC's long-distance affiliate is likely to make the Commission reluctant to press for revocation absent strong and compelling evidence that such action is warranted.

State regulators are less likely than the FCC to be effective in preventing discriminatory behavior by their local BOC. Most state regulatory commissions have a very small staff, and many lack jurisdiction in structurally competitive markets or over conflicts arising with interstate carriers. Moreover, some state regulatory commissions prefer monopoly and regulation to competition and deregulation. Frequently states pursue strategies to minimize the monthly tariff

for local service through cross-subsidization from other services, especially long distance, and so actively assist the incumbent local exchange carrier in protecting and extending its monopoly.

Concerns about monopoly leveraging from local service to long distance are real, not theoretical, because of the differences in competition between the two types of markets. Whereas competition in the long-distance market may be imperfect, it is virtually non-existent in local telecommunications services and access. Today the vast majority of residential and business customers face only highly imperfect substitutes for traditional wire-line telecommunications services. In some larger cities, facilities-based competitors have successfully entered to serve highly concentrated downtown business users with wired local access, but only a tiny fraction of customers today enjoy this type of competition.

Prospects for Local Competition

Whereas BOCs are the only wireline access provider that is available to most customers, conceivably other arrangements might now or in the near future constrain the behavior of the incumbent wireline carrier so that the anti-competitive harms described above are less of a threat. As a practical matter, consumers plausibly might face two other alternatives: radio telephony and wireline resale.

Today wireless telephone systems are widespread throughout the nation, and so offer an alternative to wireline access. To date, radio telephony still is substantially more expensive for most users than wire-line service, primarily because it has been configured almost exclusively for mobile service, rather than for fixed service from a home or office. The most important examples of radio telephony are cellular telephones and low-earth satellites, both of which are designed primarily to serve customers who want a small, pocket telephone that can be used

almost anywhere. As the cost of digital radio telephony falls, and companies take advantage of FCC policies that allow them to choose the radio telephone technology that they choose to implement, wireless access may become a serious competitor to wireline companies. But until wireless and wireline costs and prices are comparable. radio telephony can not be considered a sufficiently close substitute for wireline access to prevent monopoly abuses by local access carriers.

The other main alternative is to buy local service from a reseller, which sometimes is a long distance carrier. In this case, the facilities are provided by a local wireline monopoly at a wholesale price that typically is nearly equal to the retail price to business and residential customers. Hence, the BOC captures nearly all of the revenue from local resale and still controls the connection to the customer, including maintenance and enhancements to service capabilities. These resale arrangements, where they exist, have given rise to continuing conflicts of precisely the nature described above concerning allegations of qualitative discrimination by the BOCs.

Limitations of Resale Competition

Even if somehow discrimination against resellers could be avoided, the benefits to consumers arising from resale competition are limited. In the best of circumstances, open resale can accomplish two objectives.

First, resale competition can allow consumers and suppliers to capture whatever benefits are derived from the convenience of one-stop shopping are available. However, resale will not enable BOC competitors to capture the efficiency advantages (if any) of vertical integration in facilities. Indeed, if efficiencies of facilities integration are substantial, and the BOCs manage to keep long distance carriers out of local access, the BOCs will have a substantial competitive

advantage. Most likely, this advantage will yield higher profits and greater market power, not benefits to consumers, because BOCs will be under no competitive pressure to pass the cost savings from vertical integration on to customers. Resale competition can not prevent this outcome if the source of the benefits of vertical integration lies in integrating the facilities, rather than marketing and billing.

Second, resale competition can reduce the ability of the facilities monopolist to engage in price discrimination against consumers who have differing intensities of demand for telecommunications services. Historically, price discrimination – that is, variation among categories of customers in the difference between price and the marginal cost of service – has been rampant in the telephone industry, in no small measure due to the policies of state regulators. Regardless of the merits of price discrimination, resale is likely to reduce it. Resellers typically attack first the customers who pay prices that are farthest above the cost of service.

Nevertheless, when all is said and done, resellers have no effect on the wholesale monopoly in facilities. Even if regulation prevents the wholesale monopolist from setting monopoly prices, the monopolist will have unexploited market power, and will have the technical ability to disadvantage retail competitors in service quality in order to establish super-competitive prices in some retail markets, as well as to re-establish its ability to engage in retail price discrimination without fear of competitive retaliation from resellers.

BOC Strategies in Local Markets

In addition to the risks that BOC entry into long-distance may pose to that particular market, consumers of local telecommunications services face additional risks. Local access and

calling is a much larger market than interLATA long distance, accounting nationwide for roughly 2/3 of total telecommunications revenues. and is far more concentrated. Consequently, the financial stake of consumers in local access is far greater than it is in long distance, as is the potential gain from enhanced competition.[6] Congress deliberately structured the Telecommunications Act to encourage competition in local markets and to deny BOCs access to long distance until BOCs had taken steps to open these markets to competition. This feature of the Act reflects the judgement that additional competition in long distance is a less valuable pursuit than the introduction of some competition in local service.

The steps that are necessary for local competition to have a chance will be costly to the BOCs in two ways. First, the BOCs will have to make investments to enable efficient, effective interconnection, unbundling, local number portability, and other procompetitive technical features of the local network. Second, by facilitating competition, BOCs will lose sales to competitors. BOCs are unlikely vigorously to facilitate local competition unless they have some compensating potential benefit. If BOCs perceive that they will be allowed to enter long distance without making local competition feasible, they have a strong incentive not to facilitate local competition. By simply sitting on their hands, they simultaneously can avoid the costs of creating a competitive environment while preserving their local monopoly power and the profitable market power in long distance that the local monopoly enables them to create.

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[6]A recent study by R. Glenn Hubbard and William H. Lehr, commissioned by AT&T, estimates that effective competition in local telephone service would deliver $19 billion in annual gains to consumers (*Improving Local Exchange Competition: Regulatory Crossroads*, February 1998). While we are unaware of any comparable estimate having been for BOC entry into long-distance, it is inconceivable that it could be larger. Measured by total revenues, the long-distance market is about half the size of the local market. There has also been history of some competition in long-distance, and virtually none in local service.

Assessment of the Benefits and Risks of BOC Entry in Long Distance

For the reasons outlined in this section, the vast majority of residential and business customers obtain local access from a carrier with substantial monopoly power. Local access monopolists have the incentive and ability to leverage their market power in regulated local access to other services. As long as BOCs maintain bottleneck control over network access, they are likely to have considerable room to act on their incentives to engage in subtle forms of discrimination.

Conditions Presumptively Favoring BOC Entry into Long Distance

The problems arising from BOC entry into long distance provide general guidance for developing clear standards for granting approval of a BOC application under Section 271. For BOC long-distance entry to be presumptively in the public interest, the competitive conditions in local access must be sufficient to give consumers reasonable assurance that the BOC lacks sufficient market power to engage in effective anticompetitive leveraging into long distance. From this general principle, we derive specific conditions for presumptive approval.

Market Conditions: "Realistic Choice"

If the BOC monopoly over access to the local network gives rise to the risk of anti-competitive behavior by BOCs in long-distance, then obviously one set of presumptive conditions should consist of factors under which the BOC monopoly can be presumed to be sufficiently weakened so that the risks to competition from BOC entry into long-distance are outweighed by the potential benefits. The legislative history of the Act makes clear that the Commission is not to make this determination based on the market shares held by non-BOC

competitors in the local market. Consequently, the Commission must look to some other criteria if it desires to provide clearer guidance to all parties when BOC petitions are likely to be approved.

The list of factors that the Commission has highlighted in its Second Ameritech Decision provides a good start. But greater clarity is possible if, in establishing any presumptions, the Commission looks to whether and to what extent consumers of local telecommunications services have "realistic choices" of alternative suppliers of such services, for it is only through *actual competition on the ground* that the Commission can be reasonably sure that the BOCs will be unable to distort competition in the long-distance market. Such a test has previously been proposed by the Competition Policy Institute.[7] We propose further refinement of this test in several key respects.[8]

Consumers in a market have a realistic competitive choice when they are able to obtain basic local service at prices comparable to those charged by the BOC from several other facilities-based suppliers that can provide ordinary local access service at roughly the same cost and price as the incumbent wireline carrier. Whereas the insistence that local access be robustly competitive before BOCs can enter long distance is unrealistically rigorous, we propose that the

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[7]Comments of the Competition Policy Institute In The Matter of Application by Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934 to Provide In-Region, InterLATA Services in Michigan, CC Docket No. 91-137 (June 10, 1997).

[8]The test offered by Professor Marius Schwartz on behalf of the Department of Justice in his affidavit of May 14, 1997, is broadly similar to the one we offer here. Professor Schwartz concludes that BOC entry should be permitted only when the market has been "irreversibly opened to local competition." Superficially, this differs from a realistic choice standard, but in paragraph 20 of his affidavit, Professor Schwartz states that "by far the best test of whether the local market has been opened to competition is *whether meaningful local competition emerges*" (emphasis added). This language can read as the functional equivalent of realistic choice.

minimum standard for realistic choice be that a consumer can obtain service from at least *two non-BOC* facilities-based suppliers. The emphasis in this test is on the *availability* of local service from alternative suppliers, not on the *actual number* of customers signed up by competitors (which would be a prohibited market share test).

The basis for our choice of two competitors is drawn from the experience with radio telephony and long distance. One alternative supplier is not sufficient to provide reasonable competition, for at best that would leave local markets characterized by duopoly. The Commission has ample evidence from cellular telephone markets in a duopoly both suppliers enjoy substantial market power. In long distance. at the time of divestiture AT&T faced two major facilities-based long-distance suppliers, MCI and Sprint. These carriers provided substantial competition in both price and quality, and eroded AT&T's market share and market power to the point that, in a decade, FCC regulation of long distance could be vastly curtailed. We believe that the FCC should settle for a similar structural requirement in local service, for as long as a BOC faces a meaningful *threat* that consumers can turn to competitors, then its market power has been weakened to protect against anticompetitive leveraging from local service to long distance.

We have explicitly avoided identifying any particular technology as establishing the conditions for presumptive approval. Technological progress in telecommunications is too rapid and unpredictable for reliance on any particular method of delivering service to provide effective competition to the existing monopoly access providers. While we expect that traditional wireline access technology will remain the most cost-effective method of providing local access for most customers for many years, our standard is based on cost, not technology. If and when ground-

based wireless, cable television, fiberoptic networks, or low-orbit satellites provide access service at costs comparable to wireline service (considering both hook-up and usage costs), these technologies should then "count" as effective competitors. Thus, while we do not believe that BOCs should be barred from arguing that alternative technologies make local access reasonably competitive, we recommend that the BOCs continue to bear the burden of proof to demonstrate that the cost of ordinary telephone access using these technologies is roughly comparable to the cost of wireline access.

A natural question is whether both alternative suppliers should be providing local service predominantly or wholly through their facilities for the presumption of approval to apply. For the test for presumptive approval, *facilities-based competition* is necessary. Resale competitors have emerged in many areas, and already have been engaged in protracted controversies over the quality of service provided to their customers, the responsiveness of the BOCs to requests for service, and the wholesale prices charged to resellers. For resale competition to produce a truly competitive alternative, the market for wholesale lines must give resale companies the same realistic choice among sufficiently many competitors such that poor service and high prices by one facilities supplier can be countered by switching business to another. Thus, the presence of resale companies creates no presumption that the BOC has created the conditions necessary for local service to become reasonably competitive.

An important element of this proposal is that the "test of two" should apply to applications under *both* Track A and Track B. The latter condition, of course, is the defining characteristic of an application under Track A. The reason it must remain a minimum condition for presumptively allowing BOC entry into long-distance is that a BOC's market power -- and

thus its ability to distort competition in adjacent markets -- derives from its control over *facilities* that connect long-distance suppliers and consumers of local (and, of necessity long-distance) service to the local network. This is true regardless of whether, during the first ten months after the Act was passed, a BOC was asked to provide interconnection to another competitor (the criterion for Track B). To the extent that the conditions for entry differ between Track A and Track B, these differences should apply to the burden and standard of proof assigned to the BOCs to prove that their long distance entry is in the public interest despite the absence of adequate local competition.

The Scope of the BOC Entry Test

The Act presumes that applications for BOC entry into long distance will be made on a statewide basis. For applications seeking long-distance authority throughout a state for all classes of customers, the Commission must necessarily balance the benefits of added long-distance competition for those consumers who are not likely to be victimized by anti-competitive behavior of the BOCs against the harm that could be suffered by other consumers in regions or in customer classes who do not have a realistic choice of local service providers. For purposes of establishing a presumption of approval, what proportion of the state's consumers, therefore, must have realistic choice?

The minimum standard for presumptive approval of a BOC statewide application should at least assure that a *majority* of customers must expect to benefit from BOC entry into long distance. Because the magnitude of the dangers of premature BOC entry to consumers of both local and long-distance service is likely to outweigh the potential benefits of added competition in the long-distance market, even this requirement does not assure that the total benefits of BOC

entry will outweigh the cost; however, if a reasonably large proportion of customers in a variety of local circumstances face realistic choice, the FCC has a plausible chance to detect an attempt by a BOC to engage in anticompetitive discrimination against long distance competitors in the part of its territory in which it enjoys a local access monopoly. Thus, when judging whether an application for statewide approval would generate more benefits than costs, the presumptive approval standard should require that more than half of the customer base have a "realistic choice" in local service, as we have defined it. The practical difficulty in implementing this standard is to define the customer base to which the 50% standard applies.

The numerical standard for customers with realistic choice can be developed in two ways. One approach is to base the standard on revenues, so that an application is presumptively approved if customers accounting for more than 50% of local service revenue in a state BOC service territory (from business and residential service combined) have a realistic choice. The other standard would establish the presumption if more than 50% of the number of business and residential customers in each segment in the state have realistic choice. Given the imbalance of likely risks and benefits of BOC entry into long-distance already mentioned, either "50% test" is likely to give the benefit of the doubt to a BOC applicant.[9]

Nevertheless, the standard based on numbers of customers affords substantially greater protection to consumers than the standard based on revenues. The reason is the imbalance

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[9]Of course, either 50% test merely establishes a presumption that entry should be permitted. Evidence that the BOC applicant has engaged in a pattern of abuses with respect to potential or actual competitors would be one way of defeating that presumption. So would a specific, credible study establishing that even though more than 50% of the customers (measured either by revenues or in absolute numbers) may have realistic choice as we have defined it, the dangers of abuses to the minority of the other customers in the state are so great in the aggregate that they outweigh the potential benefits to those customers who may have realistic choice.

between residential and business rates, which would enable a BOC to come reasonably close to the revenue standard if only its business customers faced a realistic choice. In addition, a revenue test can be difficult under competition, since the local service revenues earned by non-BOC local service competitors are increasingly unlikely to be measured accurately as competition becomes more robust. Hence, we recommend that the 50% test apply separately to the *number* of both business and residential customers.

Finally, although Section 271(b) of the Act indicates that a BOC may provide "interLATA services originating in any of its in-region *States*" (emphasis added) upon meeting the appropriate conditions, the Act does not *require* that the Commission *only* accept BOC applications on a statewide basis for all customers. Accordingly, we recommend that the Commission permit BOC entry on a *less-than-statewide basis or for particular customers classes within a state (business or residential)* as long as it deems such entry to be in the "public interest." This policy would make it easier for a BOC to satisfy the 50% test, for then it need only show that *within the sub-state region and appropriate customer class (or classes)*, a majority of the customers has a realistic choice in local service providers.

We believe that the public interest would be served if the FCC were to encourage less-than-statewide entry, such as for example, when competition has emerged in a state's major metropolitan area. The economic and technical realities of telecommunications are likely to cause competitive entry in local access to be more attractive in large metropolitan markets, so that entry may well arise in a patchwork fashion within a state. We see no reason to prevent BOCs from offering long distance service within that part of the state that satisfies the "rule of two." Allowing BOCs to enter portions of the long-distance market within a state would provide

the Commission, state regulators, and the public with valuable empirical evidence of the relative benefits and risks of such entry, without at the same time risking harms to consumers who not have any or limited choice of local service providers. The Commission could run this "experiment" simply by announcing its willingness to accept less-than-statewide applications.[10]

[10]Doing so would avoid the objection that the Commission cannot unilaterally narrow the scope of a BOC application. This objection would not apply if a BOC voluntarily submitted a less-than-statewide application for long-distance entry.

Conclusion

The time has come for the Commission to help advance the day when BOCs can be allowed into long-distance service without running the risks of harming consumers in the process. We believe the best way to accomplish this objective is for the Commission to outline conditions under which it would presume such entry to be in the public interest. The guiding principle for developing a standard for presumptive approval should be that customers face a "realistic choice" among local access providers. We propose that "realistic choice" be defined as a circumstance in which fifty percent of the customers in a service class have the choice among twp facilities-based local access providers -- other than the local BOC -- that offer local service at a cost and quality that is roughly the same as wireline access service from the incumbent BOC.

Clear guidelines for granting BOC petitions for in-region long-distance authority would streamline the regulatory process and give all participants in the industry reasonable expectations about what facts will lead to approval of such petitions. The Commission can reach this objective by outlining conditions under which it would presumptively approve BOC petitions for long-distance entry (or, alternatively, to which it would assign "substantial weight," much as the Commission now must do under the Act with respect to the views of the Department of Justice).

By stating the standard as the conditions for presumptive approval, we do not mean that all such applications automatically will be granted, or that all applications that fail to meet the test will be denied. Instead, our intention is to identify conditions under which BOC entry into long distance is presumed to be in the public interest unless substantial evidence indicates otherwise. Likewise, if the presumptive conditions are not met, the application will not

necessarily be denied, but the burden of proof would rest with the BOC to show that other factors offset the dangers of anticompetitive leveraging from local service to long distance.

Robert E. Litan
The Brookings Institution
1775 Massachusetts Ave., N.W.
Washington, D.C. 20036
202-797-6120

Roger G. Noll
Professor of Economics
Stanford University
Stanford, CA 94305
650-723-2297